IFRS 13 FAIR VALUE MEASUREMENTS

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IFRS 13 Fair value measurements

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Scope

The objective of IFRS 13 is to define fair value, sets out single framework for measuring fair value and requires disclosures.
IFRS 13 applies when another IFRS requires measurement on fair value basis (both initial and subsequent) or disclosures about fair value measurements.
Standard does not apply to
- IFRS 2 Share based payments
- IAS 17 leases
- IAS 2 Inventories and
- IAS 36 Impairment of assets.

Whenever any standard specifically provide manner for computing fair value, then such standard shall be followed.

Definitions

Fair Value :
The price received by selling an asset or paid by transferring a liability in an orderly transaction between market participants at the measurement date

Active market :
A market in which transactions for acquiring or transferring the asset or liability take place with sufficient frequency and volume to provide pricing information on an continuous basis

Exit Price
The Selling price of assets and settlement price of liability

Most advantageous market
The market that maximizes the amount that would be received to sell the asset or minimizes the amount that would be paid to transfer the liability,

Principal market
The market with the greatest volume and level of activity for the asset or liability

Highest and best use
The use of a non-financial asset by market participants that would maximise the value of the asset or the group of assets and liabilities (e.g. a business) within which the asset would be used

Valuation Techniques

An entity uses valuation techniques appropriate on the basis of availability of sufficient data to measure fair value, by maximising the use of observable inputs and minimising the use of unobservable inputs.
Three widely used valuation techniques are:
- **Market approach** – uses prices and other relevant information generated by market transactions involving identical or comparable (similar) assets, liabilities, or a group of assets and liabilities (e.g. a business)
- **Cost approach** – reflects the amount that would be required currently to replace the service capacity of an asset **(current replacement cost**)
- **Income approach** – converts future amounts **(cash flows or income and expenses)** to a single current (discounted) amount, reflecting current market expectations about those future amounts.

Sometimes, a single valuation technique will be appropriate, whereas in others multiple valuation techniques will be appropriate.

Fair value at initial recognition

- Transaction price is the price paid while an asset is acquired or a liability is assumed **(an entry price**).
- Fair value is the price that would be received to sell the asset or paid to transfer the liability **(i.e. exit price).**
- However in many cases the **transaction price will be equal to fair value**
- When determining whether fair value at initial recognition equals the transaction price, an **entity shall take into account factors specific to the transaction and to the asset or liability.**

Application to non-financial assets

It refers to market participant's ability to generate economic benefits by using the asset in its highest and best use or by selling it to another market participant that would use the asset in its highest and best use

a) use that **is physically possible** taking into account the physical characteristics of the (e.g. the location or size of a property).

b) use that is **legally permissible** taking into account any legal restrictions on the use of the asset (e.g. the zoning regulations applicable to a property).

c) use that is **financially feasible** taking into account whether a use of the asset that is physically possible and legally permissible **generates adequate income or cash flows** (taking into account the costs of converting the asset to that use) to produce return on investment

Application To Financial Assets And Financial Liabilities

IFRS 13 adopts hierarchal approach to measure fair value

Fair value hierarchy

In the hierarchy the inputs used in valuation techniques categorized into three levels:

1. **Level 1 inputs**

   It refers to **quoted price of identical assets and liabilities** in active markets. Which is the most reliable evidence of fair value and is used without adjustment to measure fair value whenever available, with limited exceptions.

2. **Level 2 inputs**

   Where quoted market prices are not available then take **the price observable for similar asset or liability**, either directly or indirectly i.e. best available market data (Non Active Market)

   It includes

   i. quoted prices for **similar assets** or liabilities in **active markets**

   ii. quoted prices for **identical or similar assets or liabilities** in markets that **are not active**

   iii. inputs other than quoted prices that are observable for the asset or liability,

   iv. market-corroborated inputs

3. **Level 3 inputs**

   Level 3 inputs are unobservable inputs for the asset or liability. An entity shall use Level 3 inputs to measure fair value only when relevant observable inputs are not available.

   Fair value measurement approach

   ❖ the particular asset or liability which is subject of the measurement

   ❖ Non-financial asset, the valuation premise that is appropriate for the measurement (consistently with its highest and best use)

   ❖ the principal market for the asset or liability

   ❖ the valuation technique(s) appropriate for the measurement

Application To Financial Assets And Financial Liabilities With Offsetting Positions In Market Risks Or Counterparty Credit Risk (Exception)

❖ An entity that holds a group of financial assets and financial liabilities exposed to market risks and to the credit risk of each of the counterparties. If the entity manages that group on the basis of its net exposure to either market risks or credit risk, the entity is permitted to apply an exception to this Standard for measuring fair value.

❖ That exception permits an entity to measure the fair value of a group of financial assets and financial liabilities on the basis of the ***price that would be received to sell a net long position (i.e. an asset) for a particular risk exposure or paid to transfer a net short position (i.e. a liability)*** for a particular risk exposure in an orderly transaction between market participants at the measurement date under current market conditions.

❖ Accordingly**, an entity shall measure the fair value of the group of financial assets and financial liabilities consistently with how market participants would price the net risk exposure at the measurement date.**

❖ An entity is permitted to use the exception only if all the conditions listed below are followed:

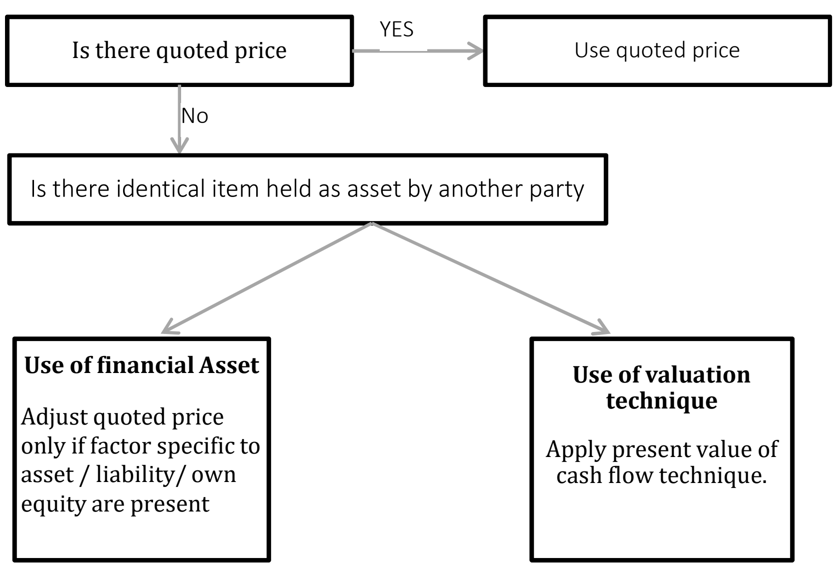
a. manages those assets and liability on the basis of the entity's net exposure or credit risk or investment strategy;

b. provides information on that basis about the group of financial assets and financial liabilities to the entity's key management personnel, as per IAS 24 Related Party Disclosures; and

c. is required or has elected to measure those assets and liability at fair value in the statement of financial position at the end of each reporting period.

Application to liabilities and an entity's own equity instruments

General Principal : Entity should assume transfer and not settlement of a liability/ own equity instruments



- ❖ Fair value of liability reflects **Non performing risk**, that entity will not be able to fulfill its obligations which includes but not limited to entity's own credit risk and might be different for different kinds of liabilities.
- ❖ Liability or entity's own equity instruments may be subject to some **restrictions** that prevent the transfer of item to somebody else but while measuring the fair value of liability or equity **instruments IFRS does not allow entity to include separate input or adjustment for such restrictions** that's because the effect of restriction is already included on inputs therefore **no separate inputs or adjustments required in Valuation.**
- ❖ Financial liability can be **payable on demand** in this case fair value of financial liability with shall not be less than amount payable on demand , **discounted** from the first date the amount would be required to be paid

Presentation and disclosure

1. An entity shall disclose, at a minimum, the following information for each class of assets and liabilities after initial recognition, for both recurring and non-recurring items:
    - ***i.*** ***<u>The valuation techniques and inputs used</u>*** to develop those measurements.
    - ***ii.*** ***<u>Fair value measurement at reporting date</u>***, for non-recurring Asset fair value measurement , reasons for measurement
    - iii. Level of hierarchy (Level 1/2/3).
    - iv. For level 2 and 3 any changes made in valuation techniques entity shall disclose the reasons for change. Where fair value categorized in level 3 entity to disclose quantitative information about the significant unobservable inputs used in the fair value measurement.
    - v. For level 3 Valuation policy needs to be disclosed
    - vi. If Highest and best use differs from current use, disclosure should be made.
2. An entity shall disclose, at a minimum, the following information for each class of assets and liabilities measured at fair value after initial recognition, for recurring fair value measurements, categorised within Level 3 of the fair value hierarchy:
    - i. Reconciliation of opening closing and changes if an
    - ii. Gains and loss recognised on transfer
    - iii. Details of Sale purchase and transfer.
    - iv. the amounts of any transfers into or out of Level 3 of the fair value hierarchy, the reasons thereof.
3. An entity shall disclose, any amounts of transfers between level 1 and level 2 of fair value hierarchy .
4. An entity shall determine appropriate classes of assets and liabilities on the basis of the following:
    - i. the nature, characteristics and risks of the asset or liability; and
    - ii. the level of the fair value hierarchy within which the fair value measurement is categorised.
5. An entity shall disclose and consistently follow its policy for determining when transfers between levels of the fair value hierarchy including following:
    - i. the date of the event or change in circumstances that caused the transfer.
    - ii. the beginning of the reporting period.
    - iii. the end of the reporting period.
6. In case of accounting decision for offsetting positions details to be disclosed
7. Disclosure shall be made in tabular format